Item No: 6.4	Classification: Open	Date: 17 July 2019	Meeting Name: Council Assembly
Report title:		Treasury Management Performance 2018-19 Annual Report and Prudential Indicators for Capital Finance and Treasury Management	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Governance	

RECOMMENDATION

1. That council assembly notes the 2018-19 outturn for the council's treasury management and that:

   - All treasury management activity was undertaken in compliance with the approved treasury management strategy and with the council's prudential indicators, as Appendix A.

   - The balance remaining on all external loans at 31 March 2019 was £677m, with £117m of new long term borrowing drawn during financial year.

BACKGROUND INFORMATION

2. In compliance with the Local Government Act 2003, the council has adopted the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The Code requires local authorities to determine an annual treasury management strategy and, as a minimum, formally report on their treasury activities and arrangements to Council Assembly mid-year and after the year-end.

3. The code provides the following objective with regard to treasury management:

   - "It is important that treasury management policies adequately reflect risk and in particular security, liquidity and yield, in that order of importance. No treasury management transaction is without risk and management of risks is the key purpose of the treasury management strategy."

4. The 2018-19 treasury management strategy was approved by Council Assembly in February 2018. Under financial delegation, all executive, managerial and operational decisions are the responsibility of the strategic director of finance and governance.

5. The 2017 Prudential Code included a requirement for local authorities to produce a Capital Strategy, a summary document approved by Council Assembly covering capital expenditure, financing and non-treasury investments. The 2019-20 capital strategy was approved by Council Assembly in February 2019.

6. The council is exposed to financial risks from short term investments, existing external debt, as well as future borrowing requirements arising from the council's capital programme. The risks include potential losses from investments and increased borrowing costs from changing interest rates.

7. The key issues covered in this report are:

- Prudential indicators for 2018-19
- The council's borrowing strategy and debt management position
- Investment performance and activity

KEY ISSUES FOR CONSIDERATION

Prudential Indicators - Actuals

8. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance, the Treasury Management in the Public Services Code of Practice and related guidance published by CIPFA. The codes require councils to set a series of indicators and limits each year. The 2018-19 indicators were agreed in February 2018, before the start of the financial year and enabled the strategic director of finance and governance to carry out his responsibilities in this area. The 2018-19 Prudential Indicator outturn details are included at Appendix A.

9. The council has complied with its prudential indicators throughout 2018-19.

Borrowing strategy and debt management activity and position

10. As at 31 March 2019 the outstanding debt held by the council was £677m an increase from £563m as at 31 March 2018.

11. The council's debt management strategy since 2011-12 has been to pursue a policy of internal borrowing, which is the use of existing reserves and balances to fund capital expenditure rather than the use of external borrowing.

12. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Borrowing in advance of need from a cash flow perspective creates a 'cost of carry' which is the difference between the short term investment income earned through holding cash balances compared against longer term external debt financing costs.

13. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the council's counterparty risk inherent in the investment of cash balances.

14. During 2017-18, it became necessary to undertake new borrowing in order to finance prior internal borrowing from the capital programme and to maintain target cash balances. During the course of the financial year 2017-18 the council elected to borrow £110m in short term loans from other local authorities.

15. The extent of the council's capital financing requirement necessitated the use of long term debt financing during 2018-19, to secure long term financial stability.

16. During the financial year to 31 March 2019 the council borrowed £117m from the Public Works Loans Board, as part of HM Treasury, in 13 separate loans, with maturity terms ranging from 35 to 49 years at an average interest rate of 2.49%.

17. The £117m borrowed in long term debt was lower than the £150m originally forecast at the beginning of 2018-19. The re-profiling of capital expenditure into future years

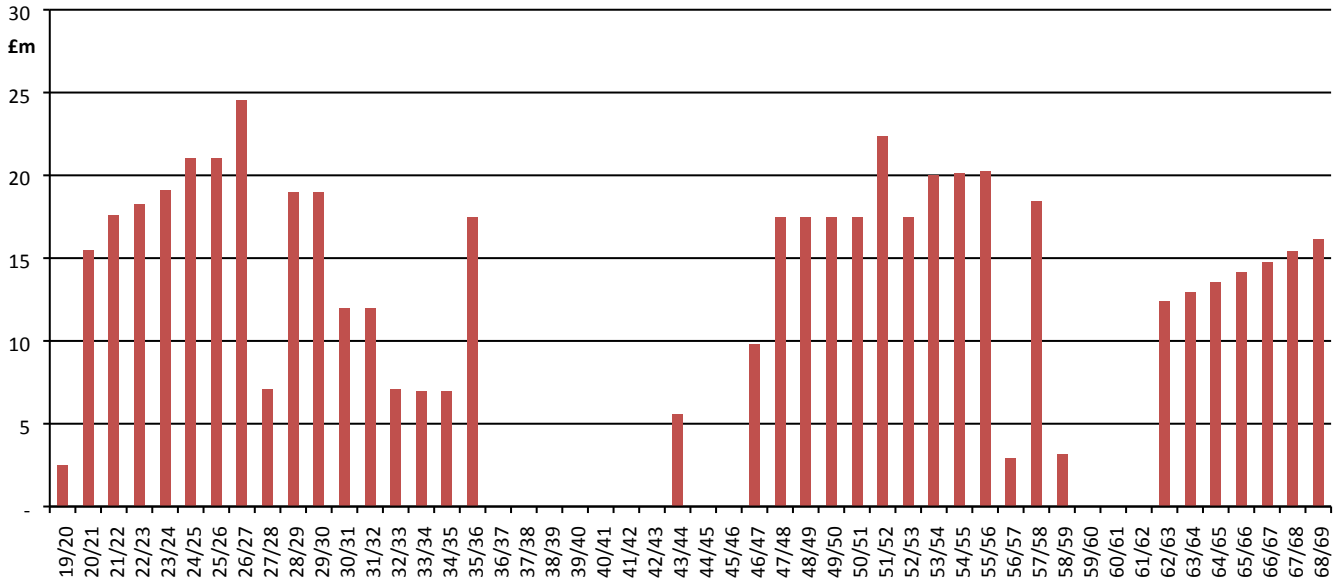
allowed the council to defer external borrowing. This had the impact of reducing the interest cost associated with debt financing to the revenue budget.

18. Drawing of long term borrowing has been supplemented by a continuation of short term borrowing from other local authorities to reduce the overall debt interest expense for the council. The level of short term borrowing from other local authorities as at 31 March 2019 was £120m.

19. Projections for approved capital expenditure and cash flows indicate that the council may need to draw further long term loans of up to £130m for 2019-20 bringing the total of new long term borrowing up to £250m by March 2020.

20. The weighted average rate of interest for the council's overall debt portfolio is 4.2% as at 31 March 2019. This reflects the largely historical nature of the debt, the majority of which was drawn prior to 2008.

21. The maturity profile of outstanding long term debt as at 31 March 2019 is shown in the chart below:



Provisions for repayment of debt

22. Each year, the general fund sets aside sums, known as the minimum revenue provision (MRP), to reduce its borrowing liabilities. In 2018-19 £8m (£6m during 2017-18) was set aside to reduce the capital financing requirement. The HRA can also set aside sums to reduce borrowing liabilities. During 2018-19 no additional sums were set aside for repayment of debt.

23. The overall level of internal borrowing at 31 March 2019 was £228m. The decrease in internal borrowing from 31 March 2018 reflects the additional borrowing frawn during the financial year after taking account of new capital spend not funded by existing resources. The council's capital spending programme is set out in more detail in the capital monitoring outturn report to Cabinet in June 2019.

24. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the internal borrowing strategy, so that the reduction in current borrowing costs from use of internal balances, is not offset by higher borrowing costs

in the future.

25. The PWLB continues to operate a spread of approximately 1% between “premature repayment rates” and “new loan” rates so the premium charge for early repayment of PWLB debt remained expensive for the council’s portfolio and therefore unattractive for debt rescheduling activity.

26. The short term debt drawn during 2018-19 will mature in 2019-20 and there will be a requirement to refinance this by drawing down further borrowing. The council will consider a number of borrowing sources, both long and short term. Decisions on the most optimal and value for money source and duration of the borrowing will be made in the context of any changes in interest rates and the longer term cash flow requirements of the council. It is expected that further borrowing will be required in 2020-21.

Investment strategy and investment activity and position

27. The council has significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Council cash that is not immediately required for current expenditure is invested in money market instruments in accordance with the MHCLG Guidance on Local Authority Investments and the investment strategy as approved by Council Assembly for each financial year.

28. In accordance with MHCLG guidance, the council gives priority to the security and liquidity of any investments made and then to seek an investment return commensurate with these principles.

29. In the year to 31 March 2019 the average daily investment balance was £132m (£127m for 2017-18) and the value at 31 March 2019 stood at £126m (£126m 31 March 2018).

30. Council investments are managed both in-house and delegated to two external fund managers: Alliance Bernstein and Aberdeen Standard Investments. The focus for in-house investment is to meet variable near term cash liquidity requirements.

31. The external fund managers invest over a longer term across a range of investment instruments including UK government gilts, supranational bank bonds, and certificates of deposits and covered bonds issued by major banks/ building societies. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council’s risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

32. The rate of return for council treasury management assets for the 2018-19 financial year was 0.81%. Uncertainty surrounding the UK planned exit from the EU alongside mixed economic data for the UK led to a fall in short term market interest rates.

33. To assess the treasury management portfolio performance, the council measures the return against a composite investment benchmark of three month LIBID and one to three year gilt index. For the equivalent period of the financial year the benchmark index annualised return was 0.77% indicating a small outperformance of the council portfolio versus the benchmark.

34. The rate of investment return generated by the treasury management portfolio is a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by MHCLG.

35. The distribution of investments by maturity and credit rating as at 31 March 2019 is set out in the table below:

Maturity Profile and Credit	A	AA	AAA	Grand Total
Less than 1 year	1%	12%	73%	86%
1-2 Years	0%	4%	1%	5%
2-5 Years	0%	0%	9%	9%
Grand Total	**1%**	**16%**	**83%**	**100%**

AAA represents the highest credit quality, AA represents very high credit quality and A represents high credit quality.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

36. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit, governance and standards committee.

37. Financial standing orders require the strategic director of finance and governance to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a regular basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and governance.

38. The Local Government Act 2003 ("the 2003 Act") and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

39. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is found in the Ministry of Housing, Communities and Local Government Guidance on Local Authority Investments updated February 2018 and there is statutory guidance on the Minimum Revenue Provision (MRP) made under section 21(1A) of the 2003 Act.

40. Section 12 of the 2003 Act grants local authorities the powers to invest for any purpose relevant to its functions or for the purposes of the prudent management of its financial affairs.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
None		

APPENDICES

No.	Title
Appendix A	Prudential Indicators – 2018-19 Actuals

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Rob Woollatt, Interim Departmental Finance Manager	
Version	Final	
Version Date	5 July 2019	
Key Decision	No	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments sought**	**Comments included**
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	Not applicable	Not applicable
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional Team		5 July 2019